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Basis for Reform of Federal Taxation

A SUGGESTION OF CORRECT PRINCIPLES FOR GENERAL REVISION OF REVENUE SYSTEM¹

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IT is generally understood that Congress must undertake a revision of revenue legislation. The war revenue acts have rendered heroic service. For the immediate purposes sought they proved to be nothing short of marvelous. The Congress is entitled to the unstinted thanks of the American people for these great tax laws. They are, however, out of joint with the after-war conditions. The laws will no longer yield the revenue which the government must have, and operate so inequitably that the fleece is not worth the cries of peace-time business and industry.

Everyone hopes that Congress will deal with this serious problem comprehensively and decisively—not piecemeal or tentatively. Congress is always reluctant to change a tax law that is producing the necessary revenue, but once convinced that the revenue will not be forthcoming, we may hope that our national lawmakers will bring forth a constructive law which will adequately support the Treasury and at the same time stimulate our economic readjustment by removing the most fruitful cause of uncertainty and hesitation.

UNDERLYING PRINCIPLES

It seems to me that before attempting to consider any of the numerous programs for tax revision which will be presented, we should get clear in mind the underlying principles and the

practical considerations which should control the decisions to be reached. The tax program itself should not be approached until the fundamentals have been laid down and agreed upon. Many citizens and groups of interested individuals have prepared elaborate suggestions for Congress. The trouble with many of them is that they start from biased or selfish viewpoints and proceed to erroneous and unsound conclusions.

For myself, I would not present and insist with Congress on a certain tax program. I prefer to leave that difficult problem to the Congress where the clearing house of ideas exists and where under the Constitution the responsibility for such legislation is lodged. My desire is that the legislators will endeavor first to get a clear understanding of the whole situation, that they will test every proposal according to its administrability and that they will act comprehensively and consistently on the entire revenue question.

CHIEF CONSIDERATIONS

If Congress proceeds in this orderly fashion it will not be so very difficult to winnow the wheat from the smothering mass of chaff. To my mind, the chief considerations are:

1. The revenue requirements should be reduced by every possible economy in operating the government and by refunding where and when safe financing will permit.
2. Salvage of war materials should be expedited and the estimated yield deducted from the revenue requirements.

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3. A tariff policy should be decided upon and consistently followed to produce revenue of a certain sum, which also should be deducted from the aggregate requirements in order to arrive at the sum which must be raised by internal taxes.

4. Tax administration should be strengthened by eliminating taxation for police or regulatory purposes.

5. Several objects of taxation are necessary, but the list should not be unduly extended.

6. No tax should be made to carry an excessive rate.

7. A tax established and working smoothly, if productive, should not be hastily discarded.

8. Entire equity can not be attained; simplicity and certainty are more important.

THE PUBLIC DEBT

The next generation will be more greatly benefited by the preservation now of the national heritage of political and economic institutions which should be passed on unimpaired, than by an immediate final distribution of the cost of the war. The resumption of normal production and distribution should not be retarded by burdens which can be avoided. The refunding of the public debt is an obvious expedient to reduce the revenue requirements and not only decrease the annual tax levy but also simplify the system of collection. Beyond a certain point a tax can not be made to yield more revenue by increasing the rate, and resort must be had to other and additional objects of taxation. Therefore, by reducing the amount of revenue required, the number of taxes, as well as the rates, may be decreased. The operations of the government must be placed upon an economic peace-time basis as early as possible. All the countries seem to be suffering from a raid on the part of unqualified citizens to serve and a disposition of those especially qualified for service to pursue business rather than

government endeavors. The country needs the constructive assistance of its best citizens as much in peace as in war.

SALVAGE OF WAR MATERIALS

With the present increasing unemployment and decreasing production in many lines the time is most opportune for closing out the vast stocks of war munitions. From clothing to building material, through a numerous category of useful articles, the government still has on hand an accumulation of products intended for the military and naval forces which should be promptly salvaged. Not only will activity in this direction be productive of considerable revenue, but an outlet can be provided for some unoccupied labor, and commodities will be made available to supplement the warehouses and shelves of merchants which are soon to be seriously depleted.

TARIFF AND TAXATION

Readjustment of the tariff in the light of changed economic conditions will probably be undertaken soon. In working out this readjustment it seems to me that it is highly important to fix upon a definite revenue objective and to adjust the various schedules to produce as nearly as can be estimated a certain sum annually. Unless the tariff is thus treated as an integral part of the revenue program it will be difficult to reduce the tax burden to the full extent which would be practicable if the yield from the tariff is decided upon in advance of all the detailed adjustments.

TAXATION FOR REVENUE ONLY

The federal taxing power has been extended to embrace matters of regulation, such as the adulteration of butter and flour, the misbranding of oleomargarine, the traffic in narcotics, intoxicating beverages and alcohol, the

employment of child labor, and the control of personal expenditures for luxuries. Quite aside from the interesting constitutional question involved in this legislative tendency, it seems to me unwise from purely administrative considerations to complicate the taxation system and to elaborate its organization for these essentially extraneous purposes. Federal taxation has grown to such proportions that good administration, as well as wise legislation, in this field is of importance paramount to even the most laudable police measures. Such police measures, including the enforcement of prohibition, should be handled by agencies separate and distinct from the Bureau of Internal Revenue. The officer charged with responsibility for administering such tax laws as we now have or any which can be substituted for them should not be required to turn aside continually from the main task to unrelated activities, which must nevertheless be carried on consistently and coördinately under the general revenue statutes. This branch of the government should be left free to concentrate and specialize on the sole problem of taxation for revenue. Economies in administration, as well as other valuable purposes, will be secured by consolidating all the federal tax collecting machinery. This would effectively coördinate the customs and internal revenue services.

OBJECTS OF TAXATION

Probably few people realize how difficult it is to inaugurate a new tax so as to drain properly an untried field of revenue. It is somewhat like the commercial experience of entering a new market, or like the industrial experience of taking on a new line of manufacture. Adjustment, conversion, recruitment and trial of men and materials are involved. Results can not be immediate. It was very fortunate that in 1917 we

had the income tax law, experience of several years in its interpretation and operation, and the framework at least of an organization. This tax soon became the keystone of the arch. The old taxes linked with the traffic in alcoholic beverages passed away (as revenue measures) with the Eighteenth Amendment, and today the income and profits tax is depended upon for three-quarters of the internal revenue.

In this situation there is danger, for the yield of any tax fluctuates with the changes occurring in the object to which it is applied. If too much dependence is placed on a single tax the national revenue will be uncertain. At the present moment conditions controlling incomes and profits are such that grave apprehension is entertained whether the existing revenue laws will yield adequate revenues. The government should not place all its golden eggs in one basket or in too few baskets. New objects of taxation are needed and must be decided upon so that the machinery for developing them may be built up, set running and made to find itself in smooth running coördination of its parts. These objects should be judiciously chosen, and, also, they should not be too numerous. Multiplicity of taxes gives rise to natural vexation and feeling of harassment on the part of the taxpaying public and administration.

MODERATE RATES

"Who pays the tax?" is a question which has given rise to so much conjecture and controversy as to suggest the answer that nobody knows. Somewhere it is absorbed. The government gets it and from someone's substance it is yielded. In the cases of taxes on business it is probable that the buyer pays the tax in the seller's market and vice versa, but each individual transaction would have to be scrutinized,

and even then the elements affecting the fixing of price are so complex that sure decisions could hardly be reached. As long as the rate of the tax is moderate, evasion will be hardly worth while, diversion of economic currents will not occur, and there will be little protest. A high rate applied to any tax, however, will stimulate evasion, divert the course of ordinary business and living to other channels, and arouse resentment. It will, moreover, defeat its own purpose by yielding less revenue than a lower rate. We have this now occurring with the income surtaxes, which are so high that savings are being driven into tax-free securities. The conclusion is obvious that even the best tax ceases to be a good tax if the rate is placed too high.

ACCUSTOMED USE

All taxes are necessary evils, and especially new taxes. I would place as the first mark of a good tax "accustomed use." The excess profits tax has had use, and we are accustomed to it. This, however, is the only good mark which this tax now has, for even its productivity is on the wane. On the other hand, the great merit of the tobacco tax is accustomed use. This is a productive, well-established tax, thoroughly absorbed by the industries, businesses and consumers affected, and reduced in operation to a fairly satisfactory routine through many years of administration by the Tobacco Division of the Internal Revenue Bureau. Even this tax should not be made to carry an excessive rate.

A new tax is a disturbing element. It carries friction and uncertainty to every point of incidence. Its effects are magnified by apprehension. Every step in its assessment and collection occasions more expense and annoyance, and is more fraught with the possibility of error and fraud during the first year of

operation than at any time thereafter until it acquires the great virtue of "accustomed use." The responsibility for imposing a new tax is serious. At the outset, a new tax should be made as simple as possible and the rate should be low.

NO EQUITABLE TAXES

The endeavor to make a system of taxation equitable is apt to lead us into many pitfalls of inconsistency and confusion. The fact is that entire equity can not be attained under any system of taxation. If a general tax law operates so as to impose gross hardship on some taxpayers it is better to repeal the law and substitute something better than to attempt to patch it up with so-called "relief" provisions. Provisions of this kind in the 1918 Revenue Act have caused more administrative difficulty and more contention and protest than any of the original provisions of the 1917 law. Certainty and simplicity are far more important in a tax measure than the abstract element of equity. If the incidence of a tax is widespread and the weight is not burdensome we need not concern ourselves too much as to whether all classes of citizens are affected alike. Taxes have a way of being absorbed into the general economic situation.

Consideration of equity should not control the decision with respect to proposed taxes, for there are many other considerations which are more important. Also the administrative machinery should not be burdened with the responsibility for distinguishing between taxpayers. We cannot hope to attain these ends suddenly or even to avoid hardships in the new law and its enforcement. Simplicity in our tax laws and sympathetic attitude in administration on the part of the public and the enforcing officers should, however, be made the burden of all endeavor.